

Michigan's Economic and Revenue Situation

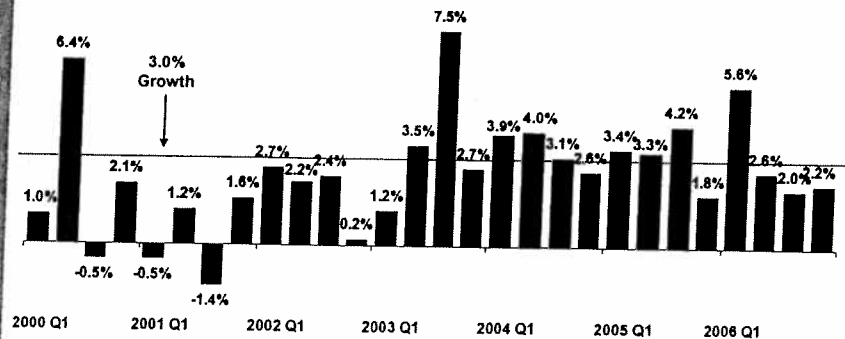
House Appropriations
and Tax Policy Joint
Committee Hearing

Robert J. Kleine
Michigan Department of Treasury
March 7, 2007

1

U.S. Economy Starting to Slow

Real GDP Growth



Source: Bureau of Economic Analysis. Figures are percent change from preceding quarter in 2000 chained dollars.

2

Length of U.S. Expansions

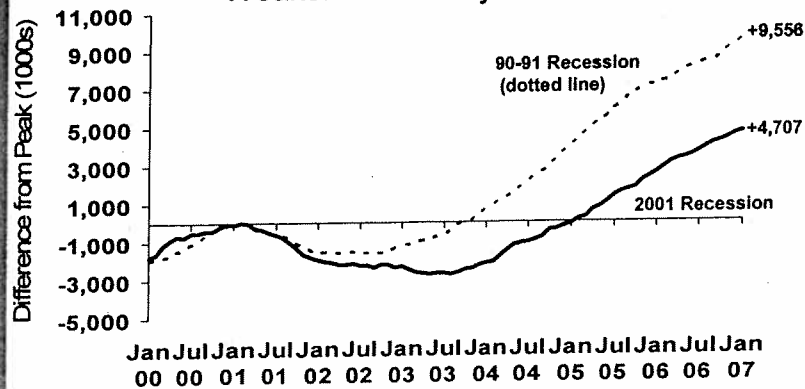
Month of Trough	Length of Expansion (Months)
Oct 1949	45
May 1954	39
Apr 1958	24
Feb. 1961	106
Nov. 1970	36
Mar. 1975	58
Jul. 1980	12
Nov. 1982	92
Mar. 1991	120
Nov. 2001	>63

3

Source: NBER

U.S. Employment Experience

Weaker Than Early 1990s

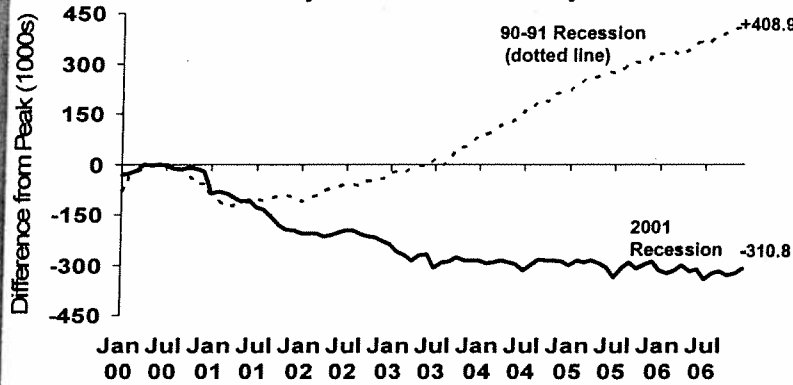


4

Source: Bureau of Labor Statistics

Michigan Employment Experience

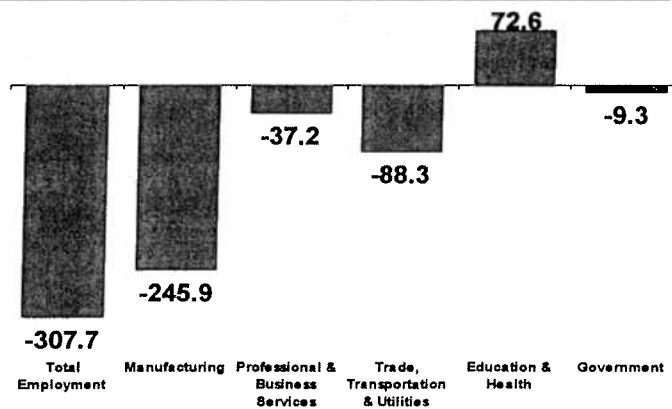
Substantially Worse Than Early 1990s



Source: Bureau of Labor Statistics

5

Michigan Employment Changes 2000-2006

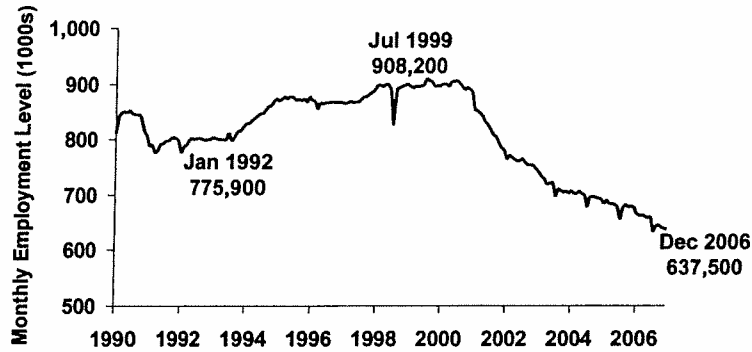


Source: 2000 actuals from Bureau of Labor Statistics;
Not all sectors reported so industry changes do not add to total change.

6

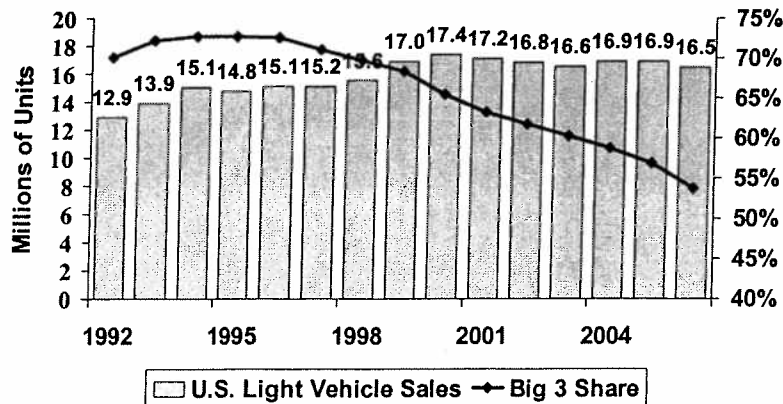
Michigan Manufacturing Employment

More Than 1 in 4 Jobs Lost Since Mid 1999



Source: Bureau of Labor Statistics

Big 3 Losing Market Share



Source: Automotive News.

Market Share Below 50%

1986 - 2011

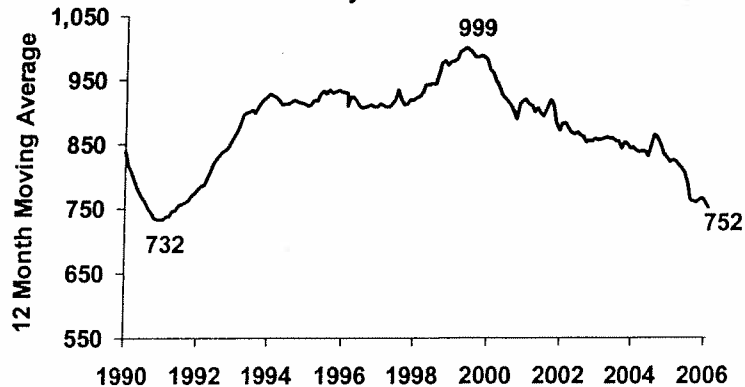
	1986	1993	2007	2011
Big 3	72.4%	73.7%	52.2%	45.2%
Internationals	27.6%	26.3%	47.8%	54.8%

9

Source: Center for Automotive Research.

Big 3 Light Vehicle Sales

Sales Have Fallen Nearly 24 Percent Since Mid 2000



10

Source: Wards Automotive

GM Restructuring

- Announced 12 facility closings and reduction of 30,000 jobs
- MI cuts announced so far:
 - Lansing Craft Center (398 employees)
 - Lansing Stamping Plant (1,398 employees)
 - Flint Engine Plant (735 employees)
 - Ypsilanti Parts Distribution (90 employees)
- Buyout offer made to all employees; 13,500 Michigan employees accepted the buyout

11

Ford Restructuring

- Closing 14 facilities, offered buyout to workers
- Wants to cut 30,000 hourly jobs and 14,000 salaried jobs nationally
- Wixom Assembly will close (1,567 workers)
- Other Michigan facilities at risk
 - Dearborn Stamping (837 workers)
 - Dearborn Diversified Manufacturing (715 workers)
 - Dearborn Engine and Fuel Tank (908 employees)
 - Wayne Stamping (1 shift)

12

Chrysler Restructuring

- 13,000 job cuts nationwide
- 2,000 salaried workers at Auburn Hills HQ
- Other Michigan cuts
 - Warren Truck – 1 shift (1,000 workers)
 - Detroit Axle (250 jobs); Mack Ave Eng (200 jobs)
 - Trenton Engine (100 jobs)
 - Sterling & Warren Stamping (165)
 - Increased efficiency at other locations (1,000)
 - Total direct jobs loss approx. 5,500
- Chrysler rumored to be for sale

13

Other Economic Events

- Pfizer closures will cost 2,100 direct jobs and 3,700 spin off jobs
- Dozens of auto part suppliers, including Delphi Corp, Tower Automotive, Dana Corp, and Collins & Aikman have filed for bankruptcy
- One in three jobs in Motor Vehicle Parts Manufacturing sector has been lost
- Comerica relocating headquarters to Texas

14

Employment Forecast

Thousands

	<u>Manufacturing</u>	<u>Private Non- Manufacturing</u>	<u>Government</u>	<u>Total</u>
2006	-31.4	9.5	-4.4	-26.3
2007	-38.0	3.2	-4.4	-39.2
2008	-30.8	7.1	-2.2	-25.9

15

Source: Total employment change is Jan. Consensus. Sector detail is Jan Admin scaled by Consensus total.

Recessions and Recoveries

Quarter of Peak Jobs Before Recession	Number of Quarters from Peak To Regain Jobs	Jobs Lost from Peak to Trough	
		Thousands	%
1960.2	9	174.1	7.3
1969.4	12	230.7	7.4
1973.4	12	216.6	6.5
1979.2	30	533.7	14.6
1990.3	11	109.4	2.7
2000.2	>34*	362.7**	7.7**

16

RSQE: January 2007

*Forecast: Current data at 26 quarters.

**Forecast: Trough quarter is 2008.3.

Michigan Private Sector Employment

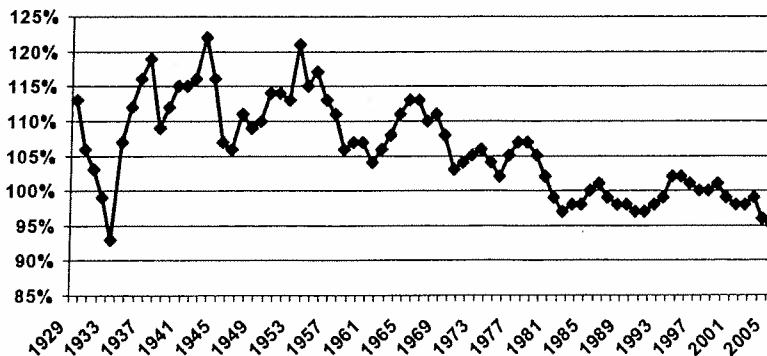
	% of Michigan Employment	Number of Jobs 12/03 to 12/06
Increasing Sectors		
Education & Health	15.3%	31,100
Professional & Business Services	15.9%	27,300
Leisure & Hospitality	10.9%	8,300
Other Private Super Sectors	13.5%	7,800
Total	55.7%	74,500
Decreasing Sectors		
Durable Goods Mfr	14.3%	-70,000
Wholesale/Retail Trade	18.2%	-34,500
Other Private Super Sectors	11.8%	-4,800
Total	44.3%	-109,300

17

Government lost 12,500 jobs from 12/03 to 12/06 and is 15.4% of total wage & salary employment.

Michigan Personal Income Falling Relative to U.S.

Michigan per Capita Income as a Percent of U.S. Per Capita Income



18

Source: Department of Treasury calculations from Bureau of Economic Analysis data.

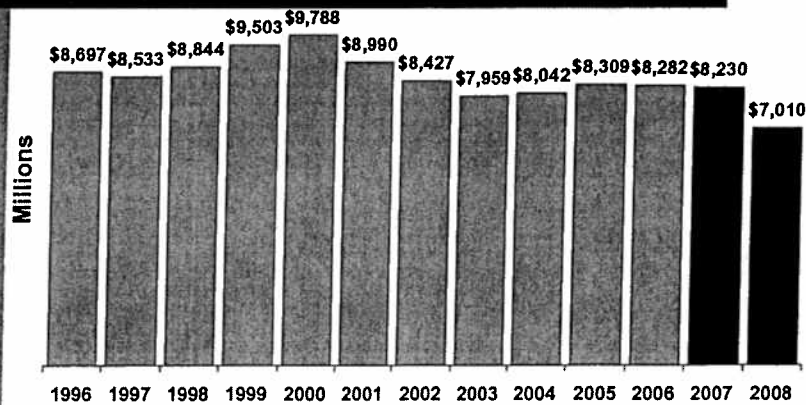
Major Taxes Perform Poorly

	Amount FY 2000	Estimated Amount FY 2007	Growth Over 7 Years
Income	\$7,136	\$6,242	-12.5%
Sales	\$6,278	\$6,732	7.2%
SBT	\$2,324	\$1,870	-19.5%
GF-GP*	\$9,788	\$8,230	-15.9%

*Does not include revenues proposed in the Governor's tax restructuring package.

19

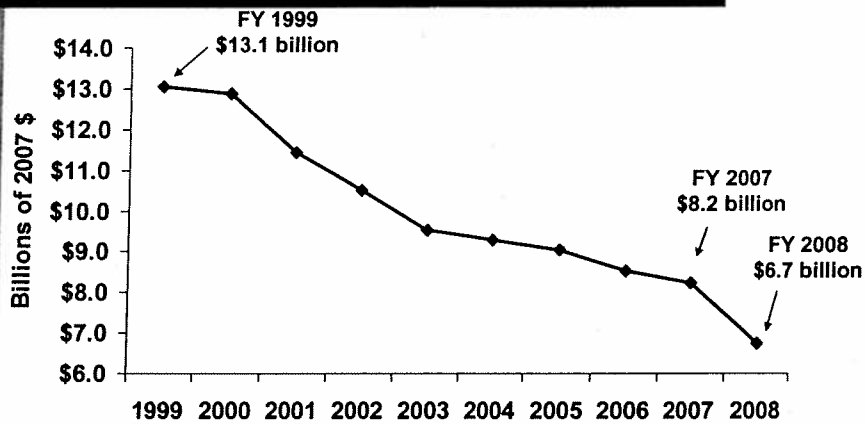
Nominal General Fund Net Revenue in 2007 Less Than in 1996



Note: Totals exclude transfers and savings from adjusting statutory revenue sharing payments to local governments. 2008 drops due to SBT repeal. Totals assume current law.

20

Inflation Adjusted FY 07 GF-GP Revenues Down 37 Percent Since FY 99



Totals exclude transfers and are adjusted to 2007 dollars using State and Local Govt Price Deflator. Totals assume current law.

Timing Issues

- The SBT replacement must be enacted rapidly to remove uncertainty for businesses to allow them to prepare
- The service tax needs to be enacted quickly to avoid mid-year cuts to education and vital services
- The cost to the state and to taxpayers of implementing new taxes increases as the timeframe is compressed

Manageable Cash Overview

Millions

FYE	Cash	Interest Income	G.O. Note	Manageable Common	CREDIT RATING		
30-Sep	GF/SAF/BSF	(Expense)	Borrowing	Cash	S&P	Moody's	Fitch
2000	\$ 2,896.0	\$ 137.3		\$ 4,892.1	AAA	Aa1	AA+
2001	2,085.7	115.0		3,868.2	AAA	Aaa	AA+
2002	599.9	5.7		2,376.2	AAA	Aaa	AA+
2003	(490.1)	(17.2)	\$ 1,248.0	1,425.7	AAA	Aaa	AA+
2004	(897.6)	(23.5)	1,300.0	1,179.6	AA+	Aa1	AA+
2005	(854.4)	(52.4)	1,275.0	1,018.9	AA	Aa2	AA
2006	(1,298.5)	(58.5)	1,299.5	860.8	AA	Aa2	AA
2007			1,306.9		AA *	Aa2 *	AA-

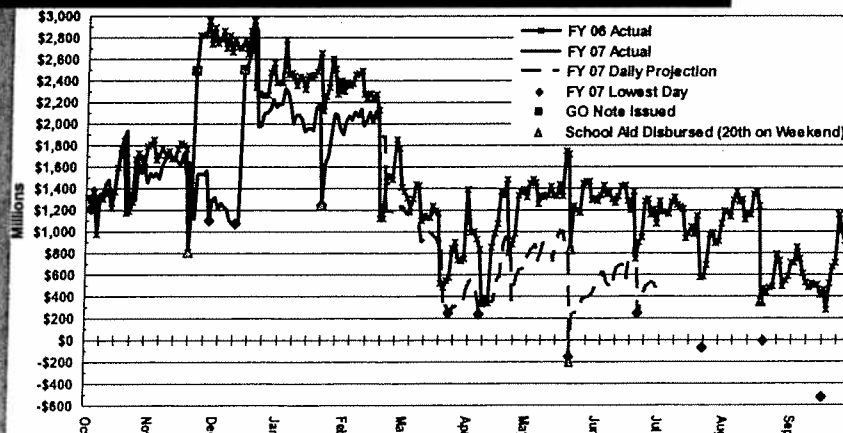
*negative outlook

- The cash balance has decreased by \$4.2 billion over the past 6 years. The BSF has been depleted.
- The cost of doing business has increased by \$216 million. The General Fund now pays interest instead of earning interest.
- External borrowing has been needed every year since 2003 to finance cash flow needs.
- The State's credit rating has decreased along with the cash deterioration. Note: Letter of Credit needed for Dec note borrowing.

23

Manageable Cash

FY 06 Actual & FY 07 Actual to Date and Projected



Includes: GO Note proceeds of \$1.3 billion note borrowing, the GO Note repayment in September, and projected 21st Century Jobs Fund Disbursements. Does not include: proposed Tax Restructuring revenue.

24

Revenues Still Struggling

	<u>Growth Last 6 Months</u>
Sales Tax	-2.7%
Withholding	-0.1%
SBT	-7.3%
Insurance Tax	-5.4%
Real Estate Transfer	-22.5%

25

Growth rates are August through January collections compared to the same period in the prior year. The SBT totals are Sept. through prelim Feb to adjust for payment timing. Aug through Jan. SBT is down over 15%.



STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

ANNIFER M. GRANHOLM
GOVERNOR

ROBERT J. KLEINE
STATE TREASURER

February 20, 2007

The Honorable George Cushingberry Jr.
Michigan Representative, 8th District
S0687 House Office Building
Post Office Box 30014
Lansing, MI 48909-7514

Dear Representative Cushingberry:

Per your request, enclosed is information concerning questions you had about Michigan's economic performance, rising energy prices and lower income households. The first attachment has several slides relating to Michigan economic activity dating back to World War II.

Tab 1: Michigan Economic Information

- Slide 1: This slide shows real Michigan personal income from 1945 to 2006. Recessionary periods are marked in gray. Except for the recessionary periods, Michigan personal income has been on a long-term upward trend.
- Slide 2: This slide shows the ratio of Michigan per capita income to U.S. per capita income. The slide demonstrates that while Michigan personal income has been increasing, the increase has been slower than the national increase. As a result, Michigan's per capita income has gone from being over 110 percent of U.S. per capita income to closer to 95 percent of the U.S. total. The ratio of Michigan per capita income to U.S. per capita income is the lowest it has been since 1933.
- Slides 3 to 5: These slides show U.S. and Michigan vehicle production. U.S. vehicle production has increased while Michigan's vehicle production has been relatively stagnant. Michigan's share of production has gone from slightly over 30 percent of U.S. production in the 1960s to approximately 20 percent of the U.S. total today.

Michigan's peak vehicle production year was 1973 when the State manufactured 4.3 million vehicles. In 2006, Michigan manufactured 2.3 million vehicles. The combination of productivity increases and the decline in the number of vehicles produced has led to reductions in the number of autoworkers needed in Michigan.

Tab 2: Business Tax Burden

The last two slides provide historical information on the percentage of taxes paid by businesses.

- Slide 6: This slide shows that in 1985 Michigan business taxes represented 5.1 percent of GSP, while in FY 2005 business taxes represented just 4.0 percent of State GSP. These figures are taken from a Senate Fiscal Agency study looking at the business tax burden. The totals represent the combined state and local tax burden.
- Slide 7: In FY 1985 Michigan state and local business taxes represented 44.2 percent of total state and local taxes, while falling to 37.9 percent in FY 2005. These figures are from the same Senate Fiscal Agency study about business tax burden.

Tab 3: Impact of Gasoline Prices

On your question about the impact of higher gasoline prices on Michigan's economy there have been several consequences. Attached is information about the effect of rising gasoline prices and overall energy prices on Michigan residents.

The Institute for Public Policy and Social Research (IPPSR) at MSU held a policy forum on energy costs in 2006 and conducted a survey among Michigan residents in late 2005. The survey results showed that energy prices are affecting travel decisions and lowering consumer confidence. Retail sales are affected due to less disposable income after spending on fuel purchases. Also attached is a fact sheet from the Alliance for Energy and Economic Growth showing the adverse effects of rising energy prices on Michigan families, businesses and farmers.

Attached are articles about the decrease in SUV sales due to higher fuel prices which hurt Michigan automakers disproportionately compared the transplant and foreign automakers. Higher fuel prices also hurt businesses with high transportation costs such as floral and other delivery businesses.

Tab 4: Taxation of Low Income Households

Also provided is information on the taxation of low-income households. A National Poverty Center working paper titled 'How Do Tax Policies Affect Low Income Workers?' supported three principal findings:

- 1) Taxes paid by low-income individuals with children have declined over the last quarter century. Low-income individuals without children have seen little change in their overall tax burden.
- 2) The proportion of taxes paid that is attributed to non-income taxes has climbed sharply over time.

Representative Cushingberry
Page 3
February 20, 2007

- 3) Marginal income tax rates have declined in very low income ranges, but have increased or stayed the same in moderate income ranges.

A Center on Budget and Policy Priorities policy brief notes that Michigan is one of 13 states with an EITC and a higher minimum wage than the federal government. Michigan also exempts food and prescription drugs from the sales tax and has property tax credits for low-income taxpayers.

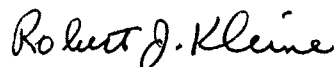
The Institute on Taxation and Economic Policy concluded in a policy brief that taxing services, especially consumer services is simply good tax policy: taxing services can make sales taxes less regressive, less discriminatory and more responsive to economic growth. But because sales taxes remain regressive – this means that provisions for low-income tax relief through an EITC or sales tax credit may be appropriate. Michigan enacted a state EITC with PA 372 of 2006. Michigan's EITC will be equal to 10 percent of the federal EITC in 2008 and 20 percent of the federal EITC in 2009.

Another Center on Budget and Policy Priorities press release shows that income inequality continues to widen as the average after tax income for the richest households rose 20 percent from 2003 to 2004. The income of the middle fifth of the population rose 3.6 percent while the bottom fifth rose 1.4 percent.

The Center on Budget and Policy Priorities released a study on the impact of state income taxes on low income families for 2005. Michigan was considered one of the states that taxed the income of working-poor families more than most other states. An individual state handout showed that Michigan consistently taxes families with income significantly below the poverty line. However, the recently enacted Earned Income Tax Credit will change how Michigan is ranked in the future.

Please let me know if you have any questions or would like any additional information.

Sincerely,



Robert J. Kleine
State Treasurer

cc: Dale Vettel (w/o attachments)
Scott Schrager (w/o attachments)
Jeff Guilfoyle (w/o attachments)
Andrew Lockwood (w/o attachments)

